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C O N F I D E N T I A L SECTION 01 OF 02 SOFIA 000625

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FOR ENERGY ENVOY GRAY, ENERGY COORDINATOR MANN, EUR DAS
BRYZA

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SUBJECT: SOUTH STREAM NEGOTIATIONS TO RESUME

Classified By: Ambassador Nancy McEldowney for reasons 1.5 (b) and (d)

11. (C) Summary: Gazprom negotiators arrive in Bulgaria September 29 to launch a new round of negotiations with Bulgargaz on a pre-shareholders agreement. In a sharp about-face, Bulgargaz appears to be depending heavily on its outside legal counsel, the U.S. firm Paul Hastings, to extract the best deal. In pre-negotiation correspondence, the Russians are taking a hard line on key issues and appear to be reopening points agreed in the hastily-signed January Intergovernmental Agreement. Bulgargaz and their attorney intend to hold their ground, hardened by their previous negotiating sessions with Gazprom. Meanwhile the Government is sending signs it intends to exert more oversight of these negotiations to ensure Bulgaria gets a good deal. End Summary.

12. (C) In preparation for the September 29 re-launch of South Stream negotiations with Gazprom, Bulgargaz and its outside legal counsel Paul Hastings met September 17-18 to discuss strategy. The September 29 session will be devoted to discussing a pre-shareholders agreement, which will spell out who pays for what until a shareholders agreement is approved. It will also determine course of action on a feasibility study for the project in Bulgaria. Paul Hastings attorneys Mark Lewis and Lubomir Roglev tell us Gazprom, to no one's surprise, is taking hard line. In documents submitted prior to the September 29 meeting, the Russians are insisting that the Bulgarians agree to a "call option" which would allow Gazprom to buy Bulgargaz's share of South Stream if Bulgargaz decides to withdraw from the project after seeing results of a feasibility study. According to Roglev, this demand is a non-starter, as it would create a 100 percent Russian-owned pipeline on Bulgarian territory. Bulgargaz is also expecting Russia to resurrect demands to use Bulgaria's existing pipeline system for South Stream, although the Inter-Governmental Agreement (IGA) signed by Russia and Bulgaria in January made reference to South Stream's existence as an additional pipeline. This, too, is a Bulgarian redline, as it would amount to giving up ownership of a percentage of the Bulgarian pipeline system to Gazprom. Gazprom is also proposing that the two sides register the South Stream company in Bulgaria before a shareholders' agreement is negotiated. Paul Hastings is recommending against this as it would give the project "more legitimacy than it deserved" before a feasibility study is done and the parties have agreed to shareholders terms.

TARIFFS AND FEASIBILITY STUDIES

13. (C) The Bulgarians expect to do battle over tariffs as

well. Bulgargaz hopes to get better terms on tariffs than were contained in the January IGA, which left much open to question. Bulgargaz and its attorneys are scratching their heads over another Russian proposal to discuss the "optimization of volumes" of gas currently transiting Bulgaria while negotiations on a shareholders agreement are on-going. Paul Hastings attorney Lewis fears that with this proposal, Russia is attempting to hold Bulgaria's current transit volumes hostage to a South Stream deal. Roglev assured us Bulgargaz has no intention of accepting a Russian-produced feasibility study, although the Russians have offered. Bulgargaz is determined to contract for an independent study, ideally not just on the part of the project located on Bulgarian territory, but for the project as a whole. As Bulgargaz is a wholly-owned state firm, the Bulgarians believe the future study will be subject to public procurement laws, something Gazprom is fighting.

RUSSIAN TACTICS

14. (C) Having represented the Bulgarians in the Burgas-Alexandroupolis oil pipeline negotiations, our Paul Hastings contacts say they are getting used to Russian negotiating tactics, which include:

- The random inclusion of seeming non sequiturs in proposals which at first seem harmless but in the end prove to have significant meaning;
- The almost constant changing of members of official negotiating delegations so that the new negotiators can feign ignorance of agreements reached with previous negotiators;

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- The referencing of completely separate agreements in seemingly innocuous ways to make the terms of those agreements open for renegotiation;
- The insistence on bilateral-only negotiations (Bulgaria-Russia, Serbia-Russia etc.) to avoid allowing any sides to team up against Gazprom. Paul Hastings is advising Bulgargaz that any bilateral work achieved on South Stream is useless without corresponding multilateral agreements (IGAs, feasibility studies, etc.) signed by all South Stream countries. Roglev and Lewis are stressing to their client that South Stream will never attract financing without such multilateral agreements.

COMMENT

15. (C) After months of ignoring the outside legal counsel it felt had been foisted upon it by the Government under pressure from the United States, Bulgargaz now appears to be depending on Paul Hastings advice. Whether this is due to the knowledge that Gazprom itself is hiring outside counsel for South Stream (Paul Hastings reps tell us Baker Botts and the UK firm Fresh Fields are in the running) or pressure from the Government, the result is positive. Galina Tosheva, Deputy Minister of Economy and Energy and Executive Director of Bulgaria's new Energy Holding Company (which was launched September 19 and includes Bulgargaz), told us she plans to demand even greater Government oversight of Bulgargaz (which has frosty relations with the Ministry and a dim view of the Energy Holding) and its negotiations with Gazprom. McEldowney